DEPARTMENT OF STATE REVENUE

04-20181872.LOF

Letter of Findings: 04-20181872
Gross Retail and Use Tax
For the Years 2014, 2015, and 2016

NOTICE: IC § 6-8.1-3-3.5 and IC § 4-22-7-7 require the publication of this document in the Indiana Register. This document provides the general public with information about the Department's official position concerning a specific set of facts and issues. This document is effective on its date of publication and remains in effect until the date it is superseded or deleted by the publication of another document in the Indiana Register. The "Holding" section of this document is provided for the convenience of the reader and is not part of the analysis contained in this Letter of Findings.

HOLDING

Indiana Retail Store Chain was subject to sales/use tax on the purchase of computer prewritten software subsequently accessed by Retail Store Chain's users located both inside Indiana and outside the state; however, Retail Store Chain was not subject to sales/use tax on charges made for the right to access computer software because Retail Store never obtained an ownership interest in that software.

ISSUES

I. Gross Retail and Use Tax - Remotely Accessed Computer Software.

Authority: IC § 6-2.5-1-27; IC § 6-2.5-2-1(a); IC § 6-2.5-2-1(b); IC § 6-2.5-3-1(a); IC § 6-2.5-3-2(e); IC § 6-2.5-3-5; IC §§ 6-2.5-5 et seq.; IC § 6-2.5-13-1(d)(1); IC § 6-2.5-13-1(d)(2); IC § 6-8.1-5-1(c); *Indiana Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579 (Ind. 2014); *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463 (Ind. 2012); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480 (Ind. Tax Ct. 2012); *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138 (Ind. Tax Ct. 2010); *Rhoade v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044 (Ind. Tax Ct. 2002); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289 (Ind. Tax Ct. 2007); *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454 (Ind. Ct. App. 1988); *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96 (Ind. Ct. App. 1974); 45 IAC 2.2-3-14(2); 45 IAC 2.2-3-16 (repealed); 45 IAC 2.2-5-3(b); 45 IAC 2.2-5-6(a); 45 IAC 2.2-5-8(a); 45 IAC 2.2-5-9(a); 45 IAC 2.2-5-10(a); Sales Tax Information Bulletin 8 (November 2011).

STATEMENT OF FACTS

Taxpayer is an Indiana company which operates a nation-wide chain of retail stores. Taxpayer operates multiple locations throughout the United States including locations in Indiana. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of Taxpayer's financial records, purchases, and tax returns. Because of the substantial number of purchases, the Department and Taxpayer agreed to review a "sample" of those transactions.

The Department's audit resulted in a proposed assessment of additional sales and use tax. Taxpayer disagreed with the assessment and submitted a protest to that effect. An administrative hearing was conducted during which Taxpayer's representatives explained the basis for the protest. This Letter of Findings results.

I. Gross Retail and Use Tax - Remotely Accessed Computer Software.

DISCUSSION

The issue is whether Taxpayer has established that it was not required to pay sales or use tax on the price paid for prewritten computer software.

A. Taxpayer's Burden of Proof.

Because the audit resulted in an assessment of additional tax, it becomes the Taxpayer's responsibility to establish that the assessment including interest, penalty, and tax is incorrect. As stated in IC § 6-8.1-5-1(c), "The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." *Indiana Dep't of State Revenue v. Rent-A-Center East, Inc.*, 963 N.E.2d 463, 466 (Ind.

2012); *Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue*, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

When a taxpayer challenges taxability in a specific instance, that taxpayer is required to provide documentation explaining and supporting its challenge. Poorly developed and non-cogent arguments are subject to waiver. *Scopelite v. Indiana Dep't of Local Gov't Fin.*, 939 N.E.2d 1138, 1145 (Ind. Tax Ct. 2010); *Wendt LLP v. Indiana Dep't of State Revenue*, 977 N.E.2d 480, 486 n.9 (Ind. Tax Ct. 2012). When an agency is charged with enforcing a statute, the jurisprudence defers to the agency's reasonable interpretation of that statute "over an equally reasonable interpretation by another party." *Indiana Dep't of State Revenue v. Caterpillar, Inc.*, 15 N.E.3d 579, 583 (Ind. 2014).

B. Indiana's Gross Retail Tax.

Indiana imposes an excise tax called "the state gross retail tax" (or "sales tax") on retail transactions made in Indiana. IC § 6-2.5-2-1(a). "When the product is received by the purchaser at a business location of the seller, the sale is sourced to that business location." IC § 6-2.5-13-1(d)(1). When the product is not received by the purchaser at a business location of the seller, the sale is sourced to the location where receipt by the purchaser . . . occurs . . . ." IC § 6-2.5-13-1(d)(2).

C. Indiana's Complimentary Use Tax.

Indiana also imposes a complementary excise tax called "the use tax" on "the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC § 6-2.5-3-2(a). "Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a).

In effect and practice, the use tax is generally functionally equivalent to the sales tax. See *Rhoade v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002). However, Indiana's use tax - not sales tax - allows an exemption for the "temporary storage" of tangible personal property delivered into Indiana but destined for use outside the state. IC § 6-2.5-3-2(e).

D. Computer Software and Indiana's Sales/Use Tax.

IC § 6-2.5-1-27 incorporates "prewritten computer software" in the definition of tangible personal property subject to sales/use tax:

> "Tangible personal property" means personal property that:
> (1) can be seen, weighed, measured, felt, or touched; or
> (2) is in any other manner perceptible to the senses.
> The term includes electricity, water, gas, steam, and prewritten computer software.

A person who acquires property in a retail transaction (a "retail purchaser") is liable for the tax on the transaction. IC § 6-2.5-2-1(b).

E. Sales and Use Tax Exemptions.

As a general rule, all purchases of tangible personal property - including pre-written computer software - are subject to sales or use tax unless specifically exempted by statutes or regulations. 45 IAC 2.2-5-3(b); 45 IAC 2.2-5-6(a); 45 IAC 2.2-5-8(a); 45 IAC 2.2-5-9(a); 45 IAC 2.2-5-10(a). Various tax exemptions are outlined in IC §§ 6-2.5-5 et seq. which are applicable to both sales tax and use tax. 45 IAC 2.2-3-14(2).

A statute which provides any tax exemption, however, is strictly construed against the taxpayer. *Indiana Dep't of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 97 (Ind. Ct. App. 1974). "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Id*. at 101 (internal citations omitted). In applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." *Indiana Dep't of State Revenue v. Kimball Int'l Inc.*, 520 N.E.2d 454, 456 (Ind. Ct. App. 1988).

F. Taxpayer's Software Purchases.

1. Akamai Technologies.

Taxpayer explains that it purchased prewritten computer software from a company called Akamai Technologies. The Department's audit found that the purchase of this software was subject to sales/use tax explaining as follows:

> [I]t was determined by the auditor that these invoices represented the purchase of Platform as a Service (PaaS). The [Akamai] invoices had both taxable and non-taxable charges, the audit only assessed tax on the taxable portion.

Taxpayer disagrees stating "[t]his is a non-taxable IaaS transaction." ("IaaS means "Infrastructure as a Service"). Taxpayer explains that this vendor provides "content hosting and content delivery of [Taxpayer's] website from Akamai's hardware and platform located outside of Indiana. Remote storage and web hosting is not taxable."

The Department's guidance on this issue is found at Sales Tax Information Bulletin 8 (November 2011), 20111228 Ind. Reg. 045110765NRA, (*superseded by Sales Tax Information Bulletin 8 (December 2016)*) which was in effect at the time of the transactions and is dispositive of the Akamai software issues raised here by Taxpayer.

> Prewritten computer software maintained on computer servers outside of Indiana also is subject to tax when accessed electronically via the Internet (i.e., "cloud computing"). *The accessing of prewritten computer software by Indiana residents constitutes a transfer of the software because the customers gain constructive possession and the right to use, control, or direct the use of the software.*

(*Emphasis added*).

In the case of Akamai software, Taxpayer was billed for the price of the various software programs and was billed separately ($2,500 each month) for the cost of "hosting" the software programs on servers not owned by Taxpayer. However, there is no indication that the audit assessed tax on these separately stated "hosting" charges. As explained in the audit report, the Akamai invoices delineated both "taxable and non-taxable charges."

The Bulletin is clear; remotely accessing computer software bought and paid for by Taxpayer is subject to Indiana's sales/use tax.

2. Cogentys Corporation.

Taxpayer states that it purchased prewritten computer software from a company called Cogentys Corporation. The Department's audit concluded that the software was subject to sales/use tax explaining as follows:

> The review of the invoices/contract conducted by the auditor determined that these licenses were PaaS (Platform as a Service). The platform control is in Indiana and the number of users and locations are not specified in the contract. Therefore, this is a taxable Indiana transaction . . . .

Taxpayer disagrees stating that software is exempt on the ground that the software is remotely accessed by numerous of its employees both within Indiana and outside Indiana. Taxpayer explains that the Cogentys software is "used to train employees nationwide" and that pursuant to the Department's sourcing rules for use tax, only those users located in Indiana are subject to use tax."

Elsewhere, Taxpayer states that Cogentys provides a "web hosting" or "design" software and is properly "considered a service" not subject to sales tax as long as tangible personal property is not transferred as part of the transaction.

As to Taxpayer's argument that accessing software constitutes a remotely accessed service, the Department must disagree. As noted above, the transactions under consideration were conducted under Sales Tax Information Bulletin 8 (November 2011) which clearly provides as follows:

> The accessing of prewritten computer software by Indiana residents constitutes a transfer of the software because the customers gain constructive possession and the right to use, control, or direct the use of the software.

For purposes of this decision, the Department's initial determination that Taxpayer was licensing software which constituted "Platform as a Service" is irrelevant. The parties' agreement specifically states that Taxpayer obtains a possessory interest in Cogentys' computer software. As stated in the parties' agreement, "[Taxpayer] shall at all

times be and remain the sole and exclusive owner of any and all deliverables and derivative works developed and/or created by Cogentys specifically for [Taxpayer] . . . as well as any technology, data and documentation, copyrights, patents, trademarks, trade secrets and other intellectual property rights created specifically for [Taxpayer]." Moreover, upon completion of the parties' agreement, "Cogentys shall provide all such deliverables and derivative works to [Taxpayer]."

The Bulletin is clear; remotely accessing computer software bought and paid for by Taxpayer is subject to Indiana's sales/use tax.

3. Nuestar Information.

Taxpayer explains that it acquired computer software from a company called Nuestar Information (a/k/a "Targus"). The Department's audit found that the software purchase was subject to sales/use tax. The audit report explained:

> The review of the invoices/contract conducted by the auditor, determined that these manual review portals were PaaS (Platform as a Service). The platform control is in Indiana and the number of users and locations are not specified in the contract. Therefore, this is a taxable Indiana transaction . . . .

Taxpayer disagrees with the Department's conclusion again arguing that "only those users located in Indiana are subject to use tax." Because Taxpayer's "digital team" is located outside Indiana, the Neustar software is not subject to this state's tax. Elsewhere, Taxpayer states that Neustar provides "a Web portal service that allows [Taxpayer] to access consumer level marketing data that is gathered, maintained and owned by the vendor." Taxpayer further states that the transactions at issue "relate to the queries and usage fee and not for the licensing charge."

Taxpayer's argument as to the number of users and where those users are located is irrelevant because the license to access by query the Nuestar software is an exempt service fee. There is nothing in the parties' agreement which suggests that Taxpayer is acquiring a possessory interest in the software. To the contrary, the parties "business term sheet" specifies that Taxpayer is charged a nominal fee for each "query" to the "Licensed Service" during the initial pilot period and thereafter a flat, monthly fee for the right to make 5,000 queries each billable period. The agreement specifies that Targus is granting Taxpayer "a non-exclusive, non-transferable license to *use*the Licensed Service solely for [Taxpayer's] Service provided by Targus." (*Emphasis added*). The agreement specifies that the agreement "does not imply a license to use any Targus service . . . other than to the extent needed for the Licensed Service" and that "[Taxpayer] shall have no right to sell, license, or distribute in any manner the Licensed Service, or any information obtained . . . to a third party."

Since Taxpayer gains no ownership interest in the Targus/Nuestar software, there was no transfer of tangible personal property and no retail transaction on which to anchor the sales tax or use tax. As explained in Sales Tax Information Bulletin 8, "The sale or lease of computer time through the use of a terminal or as a result of a batch service arrangement is a nontaxable service and is not subject to tax if separately billed or charged."

4. Kronos.

Taxpayer states that it purchased an "applicant tracking system that services the entire nationwide [Taxpayer] operation[]" from a company called Kronos. As explained by the parties' agreement, Kronos supplies a "web site for hourly/field candidates to apply for jobs including by location." The Department's audit found that the software purchase was subject to sales/use tax. The audit report explained:

> The [T]axpayer purchased and expensed Kronos software to numerous states. Therefore, the [T]axpayer wanted to remove Kronos from the projection due to the projection accounts being Indiana expenses only. The auditor agreed with the [T]axpayer and removed Kronos from the projection. The [T]axpayer stated that Kronos is an applicant tracking systems that helps managers and recruiters screen, track and hire candidates. The [T]axpayer pays a monthly fee to [access] the Kronos software. The auditor determined that this item is PaaS. Due to the contract not specifying the number of users to this service, the Department concludes that this item is software but is a platform and subject to 100[percent] use tax per [Sales Tax] Information Bulletin 8.

Taxpayer disagrees yet again arguing that, based on Indiana's "sourcing rules" and because the Kronos software is accessed remotely, "only those users located in Indiana are subject to use tax."

Kronos charges Taxpayer a fixed amount for up to "60,000 queries" and charges a single unit charge for each

additional query. A review of the invoices does not indicate that Taxpayer ever exceeded the fixed amount of 60,000 queries. In that case, the transaction falls under the rules cited above. However, in the case of the Kronos agreement, there is nothing to indicate that the deployment of the software ever involved a transfer of ownership interests to Taxpayer. To the contrary, upon termination or completion of the contract, "Kronos shall disable [Taxpayer's] ability to accept applications using the previous Services platform at all locations and through all methods." Upon termination of the contract, Kronos agreed to provide Taxpayer with all the relevant applicant information, but the software platform upon which that information resided was discontinued.

Because the parties' agreement provided Taxpayer no right, possession, or ownership interest in the underlying computer software, charges for the use of that software is not subject to sales/use tax.

5. Workday.

Taxpayer argues that it is entitled to an "offset" of sales tax paid to a vendor called Workday. Taxpayer states that the vendor "incorrectly charged Indiana tax on the entire [software] purchase and [the refund] was denied by the Department." The Department's audit addressed the Workday purchases as follows:

> The invoices for this vendor revealed that the taxpayer had paid sales to other states. These states were Arizona, New York, Ohio, South Carolina, Texas and Washington.

The audit cited to 45 IAC 2.2-3-16 for the premise that Indiana grants a use tax "credit" for sales taxes paid to other states. However, the audit found that because the credit allowed for the above listed states exceeds the 7 percent credit standard, the audit granted "a credit of only 7[percent] . . . ."

Taxpayer disagrees on the ground that the Workday software is remotely accessed by its retail locations located both within and outside Indiana and that "a refund be allowed pursuant to the software sourcing rules . . . ." Taxpayer further states that what Workday supplies "is considered a service, and therefore not subject to use tax . . . as long as tangible personal property is not transferred as part of the transaction."

The audit cited to 45 IAC 2.2-3-16 which has since been repealed. The statutory rule is found at IC § 6-2.5-3-5 which provides:

> A person is entitled to a credit against the use tax imposed on the use, storage, or consumption of a particular item of tangible personal property equal to the amount, if any, of sales tax, purchase tax, or use tax paid to another state, territory, or possession of the United States for the acquisition of that property.

Taxpayer does not quarrel with the audit decision granting Taxpayer a credit for sales taxes paid in other states but asks for an additional credit - over and above the seven percent granted - on the ground that the transaction is an exempt service. Taxpayer is mistaken. Remote access to the software is a taxable transaction under Sales Tax Information Bulletin 8 (November 2011) and the Department finds no basis for granting either an exemption or credit in excess of that previously granted.

Taxpayer has not met its burden under IC § 6-8.1-5-1(c) of establishing that it is entitled to a "credit" of tax paid on the purchase of the Workday software.

FINDING

Taxpayer's protest is denied in part and sustained in part. The price Taxpayer paid to Nuestar/Targus and the price it paid Kronos is not subject to sales/use tax. In all other respects, Taxpayer's protest is respectfully denied.

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